Buyer Negotiation Strategies in a Sellers’ Market (and Everything You Want to Know About Escalation Clauses)
Objectives

- Identify the landscape of the market segment in which you and your buyer are negotiating
- Learn to set realistic buyer expectations
- Know when using an escalation clause might be appropriate—and how to do it without losing your license
- Be ready to evaluate with your buyer other offer “sweeteners,” while balancing liability issues
- Multiple offer considerations
Why Are You Here?

• Our job is to act as a catalyst to enable our clients to make decisions in their best interests that they could not or would not make without our help. (ht Ed Hatch)
Learning the Landscape

• You will usually have more market knowledge than your buyer—but not always

• When you DO have more knowledge, start preparing the buyer as early as possible for the possibility of multiple offer situations and/or paying list price or above *if that is appropriate*
Gradual & Continuous Buyer Education

• Share information as you get it, so the buyer can develop an accurate sense of the market over time

• The alternative is an underprepared buyer or a buyer whom you try to educate only when you write the offer
Be Sensitive to Buyer Personality

- Some, but certainly not most, buyers will be comfortable making snap decisions with your input *if they trust you*!
- Most, whether they trust you or not, are simply not wired to make major decisions under pressure in a hurry.
- For slower decision makers and/or those who are highly analytical, you absolutely must educate early, giving them constant data.
Buyer Personality Issues (cont.)

- Failure to be sensitive to your buyer’s decision making process can make you come across as
  - a hard-sell pushy salesperson just trying to make a quick sale to a deliberate, analytical buyer; or
  - a slow moving agent who cost the buyer the purchase to a decisive, fast moving competitor

- If you err in either direction, you will be confronted by an Inescapable Real Estate Truth: It’s your fault!
When Buyers Know More Than You

- You may be busy with many clients in many market segments, while your buyer may be obsessing solely about her specific market segment all day and all night.
- Increasingly common buyer quote: “Did you know that this Seller paid $350,000, and that it has been on the market for 86 days, and it has had two price reductions?”
- Increasingly common agent answer: “Uh, no.”
When Buyers Know More Than You

- Sometimes you *will* know all of that, but what if you don’t?
- Ask probing questions to see what conclusions the buyer is drawing.
- Figure out if the buyer’s conclusion is correct or not
- If not, be prepared to articulate a different conclusion, and explain how that same data supports your alternate thesis
Different Analysis for New Listings

• While you should always provide buyers with objective market data to provide pricing context, newly listed properties have an added twist

• “Even if you think this might be priced high, the seller just picked that price less than 12 hours ago and is not likely to be talked down from it so soon after hitting the market.”

• “If you’re not comfortable offering list price, are you okay seeing it sell to someone else at that price?”
What Is Your Top Dollar?

• “What is the highest purchase price at which you would still be excited to hear back from me, informing you that you got the house?”

• “Above what price would you, upon learning that you got the house, kick yourself, thinking you should have gotten it for less?”
How Soon to Make the Offer

• “Take as much time as you need to decide if this is the house for you. But as soon as you decide, move forward immediately, since any delay simply increases the chances that someone else will get it after you’ve determined that you want it.”
Putting a Positive Spin on the One That Got Away

• “The good news is that your excellent taste in homes has just been validated by one or more independent third parties.”

• Humor aside, this really can help your Buyer be more comfortable with a stronger offer next time, knowing that there are obviously others with similar taste.

• This bodes well for resale demand, making a higher purchase price easier to justify
Escalation Clauses

- Viewed by some as the nuclear warhead of buyer negotiation.
- Seen by others as a dud.
- We will cover what it is and key components, so you are equipped to provide the best advice to your buyers.
Escalation Clauses: What Are They?

- A vehicle for automatically increasing your offer price in response to competing offer(s) up to a ceiling.
- Theoretically allows your buyer to avoid over-paying by limiting how much more than the competing offer the price will go.
- Theoretically increases your buyer’s chances of not being outbid if there is a sufficiently high price ceiling.
Varies by Region

- Escalation clauses are not common in all areas
- Even if you are in a market where they are not commonly used (as is the case for me), it is important to know enough about them to deal with buyers who approach you to ask if this is appropriate for their circumstances
Escalation Clause Pitfalls

• If your MLS does not offer a standard form (with your MLS or state/local Association’s logo on it), you MUST seek attorney assistance.

• While simple in theory, there are too many variables in play not to have legal counsel.

• You don’t want to jeopardize your career by practicing law without a license.
Escalation Clause: Key Components

- Base price—the initial offer price, assuming no higher offers
- Price ceiling or cap—the highest your offer will go, regardless of the competition
- Margin—how much above the competing offer will yours automatically go?
- Triggers
  - Bona fide competing offer(s)?
  - Price versus net proceeds
Escalation Clause Fail

• What if yours is the only offer?
• You just showed your hand, since the escalation clause stated explicitly the top dollar your buyer was willing to pay.
• Seller may, even in the absence of other offers, hold out for that escalation clause cap amount.
• What sort of proof? Must the listing agent and seller share the competing offer(s)?
• Is the listing agent trustworthy?
Will It Appraise?

- This is a very local market dependent consideration.
- If an escalation clause causes your buyers to pay well above list price, might it not appraise?
- If failure to appraise is a real concern, it will hurt both the buyers and the sellers to run up the price to a level that is not justifiable from an appraisal standpoint.
Getting Bogged Down by Details

• If there really are multiple strong offers, just how many hurdles can you expect the Seller to clear to take yours over the others?
• With that in mind, be cautious about telling your Buyer to demand proof of the competing offer
• Anything that becomes a Seller obstacle just creates a path of less resistance to one of the other offers
A Matter of Trust

• If you distrust the listing agent, you will be inclined to demand additional conditions, such as proof of competing offers.

• There is no good way to accomplish this

• Even if Seller agreed to provide proof of bona fide competing offer, there is no way to ensure it is not a friend who writes an offer on which the friend cannot perform, just to trigger your Buyer’s escalation clause.
Escalation Clause: Not a Panacea

- Why it won’t cure all that ails your Buyer
  - So many complex considerations that it requires legal advice and custom drafting
  - Almost always desired only in extremely fast-moving, time sensitive situations
  - Even if your attorney is reachable 24/7, erecting too many barriers will create incentive for Seller to take other offer or possibly to game yours
Then What Alternative?

• Coach your Buyers to head into negotiations on hot properties, assuming multiple offers, even if that is not the case at the moment you write it.

• Balance your determination to snag the property against your Buyers’ fear of over-paying or willingness to wait for the next one.

• You don’t want to win the negotiation, only to have your Buyers blame you for pushing them into it.
Other Deal Sweeteners

• Besides price, you might sweeten the deal by eliminating other contingencies, such as financing and inspection.

• If your Buyer *could* find a way to pay for it no matter what, consider eliminating the financing contingency, even if the Buyer will plan to obtain purchase financing if possible.

• Just know that failure to appraise or any other financing issue won’t let your Buyer bail.
Financing Considerations

• If your buyers can find a way forward, even if the property did not appraise at the purchase price, start preparing them for that early.
• “For this unusual niche property, there may not be sufficient recent comparable sales data for an appraiser to justify the price, given the appraiser’s methodological constraints. This doesn’t mean the house isn’t worth this price to you or to the next buyer, but it means you need to be ready for it not to appraise at that price.”
Appraisal Issues

• Make sure your buyers have consulted with their lender about options for making the financing work, even if the property appraises low
  ▫ How much more cash will buyers need to be prepared to kick in?

• Failure to prepare your buyers for foreseeable appraisal issues creates a much greater risk that a low appraisal will kill the deal
Sweeteners (cont.)

- While waiving an inspection contingency can be a potent way to bolster your Buyer’s offer by eliminating a huge source of Seller headaches and uncertainty, use extreme caution.
- You do not want to be blamed after closing for surprises your Buyer discovers because you urged the Buyer to forego an inspection.
- Have your firm’s legal counsel develop an informed consent form if your Buyer waives inspection.
Multiple Offer Buyer Considerations

Standard of Practice 1-15: REALTORS®, in response to inquiries from buyers or cooperating brokers shall, with the sellers’ approval, disclose the existence of offers on the property. Where disclosure is authorized, REALTORS® shall also disclose, if asked, whether offers were obtained by the listing licensee, another licensee in the listing firm, or by a cooperating broker. (Adopted 1/03, Amended 1/09)
Multiple Offer Buyer Considerations

- Must inquire; no affirmative duty by the listing agent
- With sellers’ approval
  - Rule is not absolute and seller can direct NOT to disclose
- If listing agent discloses to one, must listing agent disclose to all?
Multiple Offer Buyer Considerations

• Listing agent may lawfully and ethically have multiple offers, tell some *other* buyers’ agent that there are multiple offers, and not tell you!
• Feels unfair
• So why is this ethical?
Multiple Offer Buyer Considerations

- Dual/variable commission disclosure issues
- Standard of Practice 3-4
Multiple Offer Buyer Considerations

REALTORS®, acting as listing brokers, have an affirmative obligation to disclose the existence of dual or variable rate commission arrangements (i.e., listings where one amount of commission is payable if the listing broker’s firm is the procuring cause of sale/lease and a different amount of commission is payable if the sale/lease results through the efforts of the seller/ landlord or a cooperating broker).
Multiple Offer Buyer Considerations

The listing broker shall, as soon as practical, disclose the existence of such arrangements to potential cooperating brokers and shall, in response to inquiries from cooperating brokers, disclose the differential that would result in a cooperative transaction or in a sale/lease that results through the efforts of the seller/landlord.
Multiple Offer Buyer Considerations

If the cooperating broker is a buyer/tenant representative, the buyer/tenant representative must disclose such information to their client before the client makes an offer to purchase or lease. (*Amended 1/02*)
Multiple Offer Buyer Considerations

• This does NOT preclude an on-the-fly commission concession without disclosure in the midst of a multiple offer negotiation

• You are NOT entitled to see the listing agreement or the total commission; rather, the entitlement is only to the amount of the **differential.**